Vicom Multimedia Inc.
1997 Annual Report

Mission Statement

To excel in a global marketplace as a profitable and innovative developer of multimedia software, products and services, fostering high performance, integrity and uncompromising customer service.

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THE CORPORATION

Vicom Multimedia Inc. is a 19-year-old technology-based multimedia production and software development company. Its market sector encompasses the use of media-rich content for:

- *corporate training, marketing, technical documentation, and communication,*
- *formal education, and*
- *broadcast and entertainment.*

1997 annual report

The Corporation's focus is on two distinct business areas:

Media Production

Vicom Media Productions provides a full range of production services to a customer base primarily located in Alberta and Western Canada. Having completed over 2700 projects, Vicom Media Productions is one of Canada's largest full-service production companies. The business offers video, interactive multimedia, computer-based training, computer graphics, and print, and specializes in applications delivered on videotape or CD-ROM, and over the internet, corporate intranets or broadcast networks.

Software Development

Nereus™ and FocalCorp™, Vicom's software development businesses, provide software tools that enable more effective production, management, storage, and distribution of media-rich digital content.

The *Nereus Multimedia Publishing System* is the first commercially available technology offering a network-centric approach to both the creation and delivery of multimedia applications. It is based on an object-oriented environment where customers can achieve a level of collaboration, re-usability, just-in-time access, and project management that can reduce both time and cost of production by 25 to 90 percent.

FocalCorp Operations, Inc. offers a new generation of digital media asset management software for the organization, management, storage, location, and retrieval of the thousands of video clips, sound bites, graphics, animations, stills, web pages, etc., being created every year by most commercial enterprises.

Management believes that the Corporation's structure offers a dependable revenue stream from the media production business, and good investment potential from the two enabling technologies, Nereus and FocalCorp.

it is
preferable
to lead
rather than
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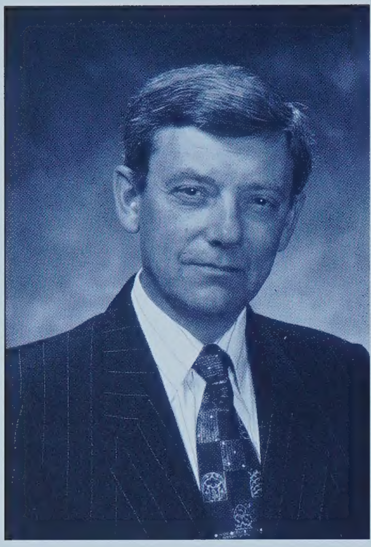
market



PRESIDENT'S MESSAGE

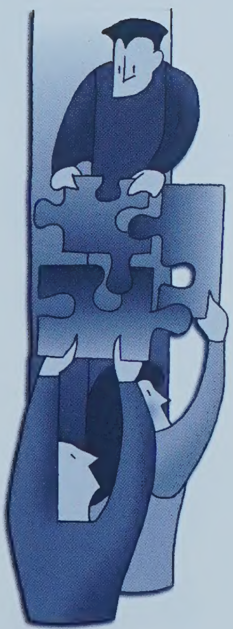
The Technology Market

Nineteen ninety-seven was a challenging year for Vicom Multimedia Inc. The return to our shareholders was disappointing, and we share that disappointment. However, we remain committed to our vision, and believe the continued investment in our technology and our marketing activities is achieving positive results. Recent Nereus™ installations for the Government of the United States, Lockheed Martin and Newbridge Networks Corp. bode well for 1998.

While offering significant revenue potential and remaining one of the growth industries of the future, the technology market is fraught with challenges. Over the last three years Vicom has established a growing market presence, and the lessons we have learned position us well for success in 1998 and beyond.

Market Readiness

Even the most astute research organizations misread the market. A prime example was the prediction of wholesale adoption of electronic commerce in 1996. That market is just now materializing. We launched Nereus in late 1996, anticipating broad adoption of network-centric/collaborative multimedia creation tools. Market awareness has been achieved only over the last few months. As we begin promoting our asset management technology, market readiness must again be considered.



We maintain that it is preferable to lead rather than follow the market, and our technologies remain on the leading edge. Successful fulfillment of this promise requires patience and continued commitment from both management and you, our shareholders, as the market matures. Our increasing knowledge and experience, combined with valuable

feedback from our customers, allows us to more accurately predict market readiness. We will continue to communicate to our investors our understanding of the technology marketplace and its readiness for our products.

our technologies remain on the leading edge

From Tools to Applications

As technology users become more sophisticated, generic broad-based tools give way to applications that provide solutions for the specific needs of well defined vertical markets. The performance of Nereus over the last half of 1997 demonstrates this change. Unique features we incorporated offer solutions these markets are prepared to buy. We have learned that these solutions require more than simply acquiring the technology. Hands-on involvement with the customer through validation, implementation, and training phases, and often throughout the creation of the first application, is necessary.

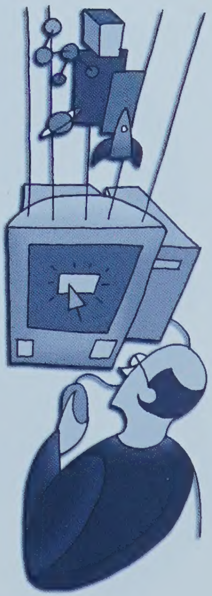
Customer Determined Product Development

With the move to applications comes the need for continuous product development based on customer input. Our belief that customer perspective should steer the development of new capabilities or features strengthens our commitment to develop and maintain strong customer relationships, particularly with industry leading companies.

Strategic Partnerships

Product bundling with companies that dominate a particular market sector offers the best opportunity for rapidly and effectively marketing new technology. In line with growing user sophistication and existing product and market allegiances, strategic partnering improves our ability to gauge and achieve strong market penetration. Such relationships also reduce the cost of taking products to market.

We are currently discussing strategic partnerships with companies that have complementary technologies and enjoy large market share.



1997 – A Year of Focus for Nereus

Following a massive marketing effort during the last half of 1996, we entered 1997 buoyed by initial market response and positive technical reviews of our core technology, Nereus.

Although we intensified sales and marketing efforts, we also encountered a sales cycle that was longer than expected. Customer feedback clarified several challenges:

- Nereus technology represents a new paradigm in multimedia production;
- Nereus technology, far more comprehensive than any authoring tool thus far, cannot compete in that price and feature sensitive market;

hands-on involvement with the customer

- Nereus and Vicom are unknowns in the multimedia software market;
- Adopting Nereus involves additional internal personnel and hardware resources.

To meet these challenges, we focused on vertical markets ideally suited to the Nereus technology.

Nereus handles large and dynamic volumes of data and the Standard General Markup Language (SGML), an ISO standard for technical documentation required by many governments and high end manufacturers. This is why we focused on the military, aerospace, and the electronic manufacturing and heavy industries moving to the use of Interactive Electronic Technical Manuals (IETMs) and demanding integrated Electronic Performance Support Systems (EPSSs). These industries are comprised of large organizations concerned with overall performance, very specific features, and product support rather than price sensitivity. Market success is based on relationship building, and involves lengthy system evaluations, prototype creation, and a large commitment to production support, training, and consultation. Overall industry acceptance based on significant reference accounts is critical.

The sales cycle, although long, results in long-time customers and large sales. Our success in establishing a number of key reference accounts was demonstrated in the third and fourth quarters of 1997. This growing momentum will enable Nereus to establish itself as the premier supplier of knowledge engineering software to these well-defined markets.

FocalCorp Operations, Inc. – Leveraging Our Technology for the Future

In the world of technology, change is a dynamic constant. Although early 1997 sales of our core Nereus technology were slow, the Corporation continued to invest in the future.

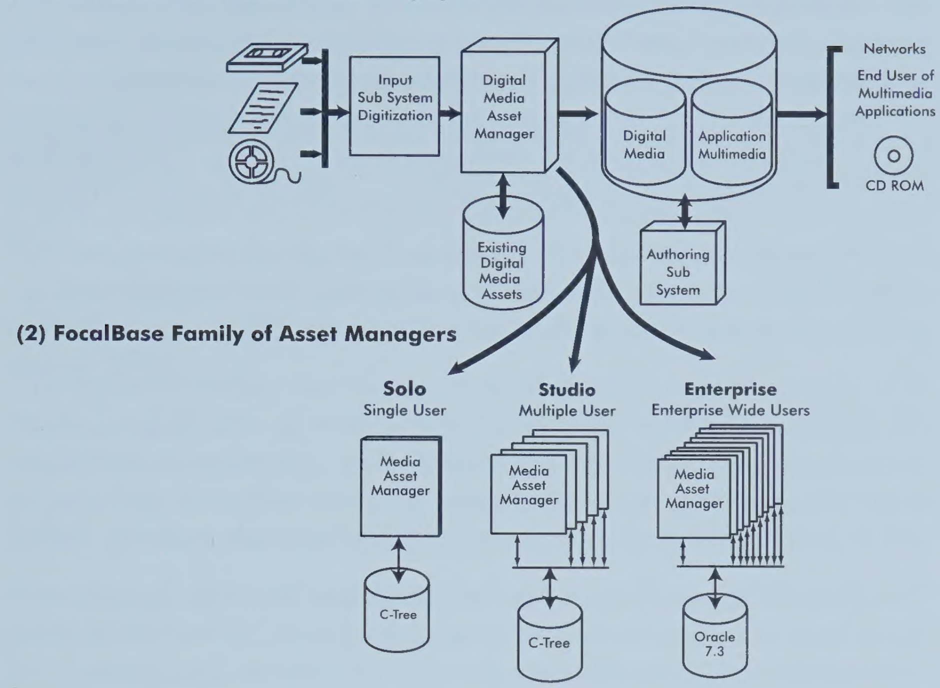
In the second quarter, Hamish Forsythe joined the Corporation to head a new division, FocalCorp Operations, Inc. Under the guidance of Mr. Forsythe, we followed the dictates of our market research and unbundled a key component of the Nereus technology, the Digital Media Asset Manager.

We enhanced the capabilities of this technology during the third and fourth quarters of 1997, which resulted in the FocalBase family of products. Version 2.1 was released during the fall of 1997, and Version 3.0 is scheduled for beta release the first quarter of 1998.

Our Two Technologies - An Overview

(1) The Nereus Multimedia Publishing System

(2) FocalBase Family of Asset Managers



renewed commitment to our long time business

These activities represent the aggressive philosophy of senior management. Rather than choosing to conserve our resources and wait for the market to materialize, we decided to continue investing in research and development. We believe this course of action has kept us on the forefront of technology and poised for success in this emerging and promising market.

We have established an undeniable presence in the U.S. marketplace and are strongly positioned to capitalize on the dawning realization that efficient asset management requires the new features and approach that our products offer. We are using the experience we gained in bringing the Nereus technology to market, and are exploring specific vertical markets and strategic partnerships that would incorporate our technology with market leaders, and thereby provide unique solutions for industry sectors involved in creating and using digital media.

a strong competitive position

Vicom Media Production – a Renewed Commitment

Since the 1994 IPO, the primary focus of senior management was on the new technologies. Midway through 1997, with corporate restructuring into three distinct business units, we undertook renewed attention and commitment to the media production business.

Our sales and marketing efforts have significantly increased during the last half of 1997. A new line of products designed specifically for our traditional service business complements the adoption of a short-term tactical initiative designed to increase our regional market share and dominance. We are encouraged by the increased activity generated, and anticipate improved results in 1998.

Also during 1997, a Special Projects division was established within the media production business, initially to handle SAFE-T-Disc™, our proprietary Safety Training Courseware. Although sales to date have been disappointing, we are exploring new distribution agreements and expect this product to consistently generate revenue during 1998.

The Special Projects division has partnered and acquired the exclusive rights to develop, produce and market an electronic version of the Taekwon-Do Encyclopedia and life story of Taekwon-Do inventor, General Choi. The four disk CD-ROM package is now complete and in the early stages of distribution. With forty million practitioners worldwide, we are excited about its revenue potential.

Special Projects, in partnership with Telus, won a contract to set up and manage a new high-tech tourism marketing system in the Calgary International Airport. As well as potential significant revenues from this first contract, the technology and concept could be exported to many other airports across North America.

Another special project is the development of a broadcast series of eight one-hour programs titled *Rebels* which has been pre-sold to CTV and the History Channel. Revenue may also come from additional network sales and video tape distribution.

Much of the investment in these projects was made in 1997. We expect to see returns on this investment and an improvement in the overall performance of Vicom Media Productions during 1998.

Our Challenge in 1998

aggressive marketing and sales

Our number one challenge in 1998 is increasing the value of our stock and, thus, the return for our shareholders. In meeting this challenge, we face the internal tasks of carefully husbanding our resources and minimizing expenditures, and the external pressures of a cautious technology investment market. We have little control over the latter, and so must concentrate on two primary issues: increased revenue combined with minimized expenditures.

The lessons we have learned combined with activities underway within our business units have, we believe, given us the right mix of technology and sales and marketing activities to demonstrate increased revenue during 1998.

We have taken steps to reduce overall expenditures, and have implemented even more stringent measures for 1998. A plan is in place to fast track both research and development and sales activities should revenues, new partnerships, or additional resources permit.

We anticipate the technology investment marketplace will remain cautious for 1998. From that perspective, we understand the recovery of our stock is contingent on showing a continuous increase in revenues with a parallel move to overall profitability over a number of quarters.

We face the challenge from a strong competitive position and with renewed vigilance, both for increasing the efficiencies of all operations and for taking advantage of industry leading technologies. This is our goal and focus for 1998.

our technology represents the next generation of software

Multimedia and the Business of Information Technology

Tracing the history of mankind, we see that each new development in communications technology brought changes in how we dealt with information and caused paradigm shifts in the world's social and economic landscapes. This decade has witnessed development of mankind's ability to gather, store, manipulate, and distribute information at an unprecedented pace. It has been only 40 years since the mass introduction of television, and 20 years since the first PC entered the marketplace. Within this short time frame, information has become a strategic resource. By all accounts, Information Technology (IT) is the growth industry of the next decade and beyond.

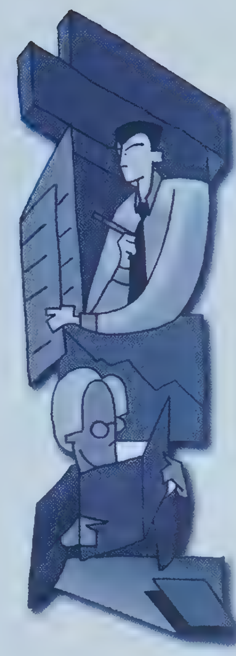
When considering an investment opportunity, it is important not only to evaluate the company, but also to evaluate the industry and how well the company is aligned to trends in that industry.

A number of key trends are emerging within the IT industry. They include worldwide conversion to digital technologies, development of low-cost, high-speed networks (Internet/Intranet), the move to network-centric/server-based computing, and the explosion of new media assets at the desktop. On the creation side, the trend is toward highly collaborative environments linking people and assets, locally or globally.

Consequently, multimedia has emerged as a predominant force within the IT industry. As communication, computing, and entertainment platforms for business and personal use increase in power and popularity, multimedia has become a larger part of the workplace and the home. Users are able to interact with media such as text, sound, graphics, animation, data, and video simultaneously, resulting in richer, more powerful communication. The end user is able to select information in the form and function best suited to match learning styles and time pressures.

Management believes the production expertise and proprietary software tools and technologies that Vicom Multimedia Inc. has developed offer a significant competitive advantage, and positions us well to take advantage of the new technology trends and the growth of multimedia. In particular, there is a need for ubiquitous technology that can manage and store digital media assets as well as create and deliver multimedia applications. Our technology represents the next generation of software, from the individual "user-centric" to the enterprise "network-centric" and collaborative model for both media asset management and the creation of multimedia applications.

MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS



Management has prepared the following discussion as a review of the Company's operating results and financial condition based on Canadian generally accepted accounting principles. It should be read in conjunction with the Company's 1998 audited consolidated financial statements, including the notes thereto.

General

The Company continued its extensive investment into the high technology area during fiscal 1998.

- Nereus™ and FocalCorp™ continued development of new technology, particularly in the asset management area. Almost $1,000,000 was invested in further research and development during the year. The loss for the business unit for the year, including the above research and development, amounted to more than $2,600,000. As in prior years, the Company has expensed all software development expenditures.
- The Media Production business was in a net loss position for the first year in many. As outlined in more detail below, this is largely due to investments made in special projects, tighter margins due to competitive circumstances and some excess capacity in production capabilities.
- The Company advanced $1,200,000 (US$ 825,000) to SourceSys during the year to fund operations. Vicom's share of SourceSys losses amounted to $960,000.
- The Company also invested more than $500,000 in capital asset purchases, including production equipment, sales equipment and a Management Information System (MIS) needing replacement in order to be year 2000 compliant.

Results of Operations

During the year, a re-organization of the Company was undertaken to streamline the operations of each of the principal businesses. The three segments are: The Media Production group, which now includes the operations of SAFE-T-Disc™; the Nereus Multimedia Publishing System group, and the FocalCorp Digital Asset Management group. In addition, the Company reports the results of its investment in SourceSys, Inc., a Houston based joint venture, on a proportionate consolidation basis. Because of the similarity of the businesses of Nereus and FocalCorp, these have been reported as a combined segment in these discussions. Operations highlights for each of these segments for fiscal 1998 and 1997 are shown in Tables 1 and 2, respectively.

Table 1 Operations highlights for the year ended January 31, 1998 ($ 000's)

	Media Production	Nereus and FocalCorp	SourceSys	Unallocated Corporate Costs	Consolidated
Revenue (including interest)	$4,710	$ 686	$ 849	$ 100	$ 6,345
Gross Profit	1,477	264	360	100	2,201
Selling, marketing, general and administrative	1,375	1,951	873	1,280	5,479
Amortization	232	101	138	120	591
All other expenses	13	957	308	–	1,278
Total	1,620	3,009	1,319	1,400	7,348
Net Loss	$ (143)	$(2,745)	$ (959)	$ (1,300)	$(5,147)

Table 2 Operations highlights for the year ended January 31, 1997 ($ 000's)

	Media Production	Nereus and FocalCorp	SmartCatalog	Unallocated Corporate Costs	Consolidated
Revenue (including interest)	$4,861	$ 1,020	$ 128	$ 247	$ 6,256
Gross Profit	1,999	690	103	247	3,039
Selling, marketing, general and administrative	1,083	1,034	617	1,404	4,138
Amortization	242	120	6	37	405
All other expenses	52	1,187	21	–	1,260
Total	1,377	2,341	644	1,441	5,803
Net Loss	$ 622	$ (1,651)	$ (541)	$ (1,194)	$ (2,764)

Media Production

Revenue from media production was $4,710,000 this year compared to $4,861,000 last year. The current year's revenue results, in part, from Management's decision to invest in several long-term projects that tied up production capabilities, and correspondingly, reduced potential revenues. Among other ventures, these include *Taekwon-Do* and *Rebels*. In order to secure a 50% interest in all future revenues and profits from all products related to the *Taekwon-Do* project, Vicom invested $175,000 in production costs related to this project. Production revenue recorded in the year for this production work amounted to $95,000. Subsequent to year end, the *Taekwon-Do* project has sold more than $100,000 worth of its first product (Vicom's portion $50,000), representing approximately 15% of the anticipated product revenue from the joint venture's first product.

Rebels is a six part video broadcast series in which Vicom retains a 40% interest in all future revenues. Production costs incurred as a result of work on this project, together with other similar projects during the year amounted to $98,000. *Rebels* had more than $450,000 of presale commitments at the time of signing, none of which has been recognized to date.

As a result of the investment of production capacity in these projects, together with continued margin pressure from competition and some unutilized capacity in our production teams, the gross margin for the year was 31%, compared with 41% last year.

Nereus and FocalCorp

The latter half of last fiscal year and the first half of this fiscal year saw the launch of the Nereus product into the market. Buoyed by the initial sale of the early TekDisc™ technology to Sencore, Inc. of South Dakota, the Company felt that the market was ready for the Nereus technology and aggressively began marketing the product.

By the end of the first quarter of this year, the Company began unbundling the asset management technology incorporated within Nereus. This was undertaken in response to comments from the broader multimedia market that reviewed the technology and repeatedly requested the Company sell the technology in individual components. Many industry pundits agreed that the asset management market was primed for digital asset management. The Company resisted this move for some time, but yielded to these demands in the first quarter. During the second quarter, the Nereus product development team focused almost exclusively on the asset manager component.

The third quarter saw a realignment of the Nereus group down two business lines – strategic vertical market development of the publishing system under the Nereus banner and development of broader market asset management tools under the FocalCorp name.

The formal establishment of Nereus and FocalCorp as two separate businesses within Vicom also occurred at that time.

Nereus revenues for the year were $686,000 compared with $1,020,000 last year. Last year's revenue was substantially from one source which involved the licensing of the TekDisc technology and exclusive market representation for the Interactive Electronic Technical Manuals (IETM's) for the consumer electronics industry. During the current year, more than 92% of revenues occurred in the last two quarters, with licenses to Newbridge Networks, Lockheed Martin, the United States Government and other such notable customers.

SourceSys Joint Venture

SourceSys, Inc. is a company jointly owned by Vicom and the founders of DataCat International Inc. Its main line of business is the conversion of client data from free-form text to highly structured data formats. The need for this process has become increasingly apparent as companies attempt to migrate information from legacy systems to integrated Enterprise Resource Planning ("ERP") applications. This process of rationalizing and categorizing data is known as Common Language Generation ("CLG").

During the year, Vicom advanced SourceSys US $825,000 to fund operations before advising SourceSys that Vicom would provide no further funding of operations. As a result, in the late fall SourceSys reorganized its operating and capital structure. It reduced personnel and restructured its debt in order to reduce operating costs to the point where it hopes to have the ability to fund its own operations. The restructure also positions the Company to seek outside partners or investors in order to fund further growth. SourceSys is actively seeking such partners.

Outlook

The following statements reflect Management's expectations for the Company given the unique economic circumstances and associated risks inherent to companies involved in the development of high technology. As with any discussion of forward looking matters, actual results may vary from those outlined below.

The backlog for the production centres has been increasing steadily since year-end and we are cautiously optimistic that the Media Production Group will see the growth anticipated but not achieved last year.

SourceSys has reduced its costs and is presently operating on its own cash flow. It hopes to continue to do so until it secures strategic partners that can assist in moving forward.

The Company recognizes that it cannot continue to fund the investment in the Nereus and FocalCorp technologies without additional capital. It also recognizes that it cannot penetrate the market to the depth required without partners with considerable reach into these markets. The Company is currently seeking such partners and assistance from both financial and marketing perspectives. In the short term, the Company will continue to lose money until the additional financing and market reach are secured.

Liquidity and Capital Resources

At year-end, the Company had $1,420,000 of cash and short-term investments on hand. In addition, the Company had secured authorized credit facilities of $1,300,000, representing a revolving loan of up to $1,000,000 to finance working capital and a $300,000 reducing loan to purchase capital assets. These credit facilities are secured by a general security agreement in favour of the lender.

The Company has significantly reduced its cash flow requirements over the last twelve months. Personnel have been reduced from more than ninety-five full time staff at this time last year to a current level of eighty-two. Capital expenditures over the last two quarters, with the exception of the MIS, were significantly reduced over previous quarters. SourceSys will no longer be funded by the Company.

The cash on hand, together with credit facilities in place, should be sufficient to fund operations, debt retirements and capital purchases until such time as funding has been secured for the software business.

Risks and Uncertainties

The Company is subject to the risks normally associated with the operation of a software product development and production service business. The Company must ensure that adequate systems and resources are available to respond to competitor advances or market demands.

The success of the Company, is and will always be, dependent on its ability to retain strong management and skilled personnel. The loss of such personnel could negatively affect the Company.

Service revenues are highly dependent on the Alberta economy, and more particularly to the Edmonton and Calgary markets. The number of competitors in each of these markets is very high. Vicom distinguishes itself in these markets by being one of the largest players in the local markets. Price sensitivity is always an issue on smaller production service contracts. The Company's market niche is seen as the higher volume production jobs where its eighteen years of experience is seen as a strong competitive edge.

There are a number of risks associated with the development and marketing of technology based products such as those marketed by the Company. The multimedia markets are relatively new and technology is changing rapidly. The Internet and the World Wide Web have, and will continue to impact the multimedia market.

Industry experts such as The Gartner Group, Seybold Publications and Interactivity Magazine positively reviewed the Company's core technology. Already, new competitive products are starting to emerge. One or more of these may prove superior in product design. Although the Company has taken the necessary precautions to protect its intellectual property, it may be possible to imitate, copy or otherwise obtain its intellectual property. Outside of North America and Western Europe, effective protection of intellectual property may be limited.

High-end enabling technology does not itself guarantee success of a product. Market presence and market perception play essential roles in the success of any software product. Vicom is a small and young player in the software industry, and many companies are cautious when dealing with what may be perceived to be "upstarts" in the software business. Many small software companies are faced with the issue of whether prospective purchasers are prepared to make a large investment in technology from a company with no record of accomplishment in the software arena. Vicom is addressing these issues and risks by hiring experienced software people, and creating sales and marketing strategies to minimize such concerns.

Year 2000 Issues

The Company has begun the process of ensuring that all equipment and software needed to carry on business is capable of doing so beyond December 31, 1999. This includes a new MIS implemented at year end in preparation for use this year. The Board of Directors appointed a senior officer of the Company to ensure that all significant issues are addressed. Costs associated with ensuring compliance of all critical operations equipment are not known at this time.

The Nereus and FocalCorp products are all Year 2000 compliant, as are all multimedia applications now being developed by the Media Production Group.

To date, the Company has spent more than $150,000 to ensure that its accounting and other information systems are Year 2000 compliant. In addition, a number of workstations were upgraded in order to be Year 2000 compliant and capable of running the new MIS client software.

MANAGEMENT'S REPORT

The consolidated financial statements of Vicom Multimedia Inc. were prepared by Management in accordance with accounting principles generally accepted in Canada. The financial and operating information presented in this annual report is consistent with those financial statements.

Management has designed and maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to facilitate the preparation of financial statements for reporting purposes.

KPMG, as the external auditors appointed by the shareholders, have conducted an independent examination in order to express their opinion on the consolidated financial statements. These financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

Paul H. Braconnier
Chief Financial Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Vicom Multimedia Inc. as at January 31, 1998 and 1997 and the consolidated statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG

KPMG
Chartered Accountants

Edmonton, Canada
March 27, 1998

Consolidated Balance Sheets

January 31, 1998 and 1997

	1998	1997
Assets		
Current Assets		
Cash and short-term investments	$ 1,419,601	$ 6,278,020
Accounts receivable and accrued revenue	1,097,856	1,396,476
Work-in-progress, at cost	14,274	16,739
Prepaid expenses and deposits	111,236	158,641
	2,642,967	7,849,876
Capital assets, net of amortization (note 2)	2,340,374	2,195,501
Advances to joint venture [note 3(c)]	159,417	315,921
Goodwill [note 3(a)]	374,000	241,068
	$ 5,516,758	$ 10,602,366

	1998	1997
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable and accrued liabilities	$ 1,284,757	$ 1,119,157
Production advances	226,626	–
Current portion of long-term debt (note 4)	499,802	304,448
Capital lease obligation	78,008	50,964
	2,089,193	1,474,569
Long-term debt (note 4)	–	619,484
Shareholders' equity:		
Share capital (note 5)	14,288,642	14,292,182
Cumulative translation account	(40,713)	–
Deficit	(10,820,364)	(5,783,869)
	3,427,565	8,508,313
Commitments and Contingencies (note 6)		
Subsequent event (note 11)		
	$ 5,516,758	$ 10,602,366

See accompanying notes to consolidated financial statements.

On behalf of the Board

Dale Hardy
Director

Dan Chugg
Director

Consolidated Statements of Operations and Deficit
Years ended January 1998 and 1997

	1998	1997
Revenue	$ 6,245,239	$ 6,008,363
Production Costs	4,144,018	3,216,959
Gross Profit	2,101,221	2,791,404
Interest Income	100,474	246,962
Expenses		
General and administration	2,654,578	1,740,315
Marketing	1,617,367	1,494,282
Selling	1,207,254	903,081
Amortization	591,652	405,132
Interest on capital lease obligation	6,151	3,043
Research and development (note 7)	1,056,059	1,256,587
Writedown of goodwill [note 3(a)]	214,884	–
	7,347,945	5,802,440
Loss for the year	(5,146,250)	(2,764,074)
Deficit, beginning of year	(5,783,869)	(3,019,795)
Application by joint venture of contributed surplus to deficit [note 3(a)]	109,755	–
Deficit, end of year	$ (10,820,364)	$ (5,783,869)
Loss per share	$ (0.281)	$ (0.173)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years ended January 31, 1998 and 1997

	1998	1997
Cash provided by (used in):		
Operations:		
Loss for the year	$ (5,146,250)	$ (2,764,074)
Items which do not involve cash:		
Amortization	591,652	405,132
Loss (gain) on disposal of capital assets	–	6,188
Writedown of goodwill	214,884	–
Change in non-cash operating working capital:		
Accounts receivable and accrued revenue	298,620	(118,279)
Work-in-progress	2,465	(1,452)
Prepaid expenses and deposits	47,405	(92,833)
Accounts payable and accrued liabilities	126,085	416,524
Production advances	226,626	(679,822)
	(3,638,513)	(2,828,616)
Financing:		
Proceeds of long-term debt	104,250	285,045
Repayments of long-term debt	(528,380)	–
Increase in capital lease obligation	69,554	42,580
Repayments of obligations under capital lease	(42,510)	(20,350)
Net proceeds from issue of shares	–	9,509,785
Redemption of share capital	(3,540)	–
	(400,626)	9,817,060
Investments:		
Additions to capital assets	(718,691)	(673,333)
Proceeds on disposal of capital assets	8,350	13,233
Increase in accounts payable and accrued liabilities relating to capital asset additions	39,515	17,455
Advances to joint ventures	(217,496)	(311,880)
Share of joint venture's capital transactions	109,755	–
	(778,567)	(954,525)
Increase in cumulative translation account	(40,713)	–
Increase (decrease) in cash	(4,858,419)	6,033,919
Cash and short-term investments, beginning of year	6,278,020	244,101
Cash and short-term investments, end of year	$ 1,419,601	$ 6,278,020

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended January 31, 1998 and 1997

The Company is engaged in multimedia video and interactive communications and software development. The Company is subject to the provisions of the Business Corporations Act of Alberta and its shares are listed on the Alberta Stock Exchange.

1. Significant accounting policies:

(a) Basis of consolidation:

The consolidated financial statements include the accounts of the Company's wholly-owned subsidiary company, FocalCorp, Inc., incorporated in the United States on August 1, 1997. These financial statements also reflect the Company's proportionate interest in two joint ventures, SourceSys, Inc. (formerly Datacat International Inc.), a United States company, and Com-Do Corp., a Canadian company.

(b) Goodwill:

Goodwill represents the Company's proportionate share in the goodwill recorded by SourceSys, Inc. at the time of the joint venture partners' contributions on January 1, 1997. Goodwill represents the excess consideration paid over the fair value of net identifiable assets contributed, and is being amortized on the straight-line basis over three years. On an ongoing basis, management reviews the valuation and amortization of goodwill, taking into consideration any events and circumstances which might have impaired the fair value. Goodwill is written down to fair value when declines in value are considered to be other than temporary based upon expected cash flows of the joint venture.

(c) Capital assets:

Capital assets are stated at cost. Amortization is provided using rates sufficient to amortize the costs over the estimated useful lives of the assets. The declining balance method is used for all capital assets except leasehold improvements which are amortized on the straight line basis over the term of the lease. The annual rates are disclosed in note 2.

(d) Research and development costs:

The Company expenses research expenditures. Program and software development costs are expensed as incurred unless they meet generally accepted accounting criteria for deferral and are reassessed on a quarterly basis for continuing applicability. Research and development costs are reduced by the related government assistance, tax incentives and related revenues.

Amortization commences once the product has achieved commercial acceptance and is calculated using the straight-line method over the remaining economic life of the product, such a period not exceeding three years.

(e) Revenue recognition:

Software license fees are recognized as revenue upon the fulfillment of all significant obligations under the terms of the license agreements. Revenue related to customized software packages, including implementation and installation services, is recognized on the percentage-of-completion basis. Fees from software support agreements are initially recorded as deferred revenue and recognized over the term of the agreements.

(f) Foreign currency translation:

All operations undertaken in currencies other than Canadian dollars have been determined to be self-sustaining. The assets and liabilities of these non-Canadian operations are translated at fiscal year end exchange rates. The resulting unrealized exchange gains or losses are accumulated as a separate component of shareholders' equity in the cumulative translation account. The revenues and expenses of such operations are translated at exchange rates prevailing during the fiscal year.

Notes to consolidated financial statements, continued

1. Significant accounting policies, continued:

Other monetary assets and liabilities which are denominated in foreign currencies are translated to Canadian dollars at fiscal year end exchange rates, and transactions included in earnings are translated at rates prevailing during the fiscal year. Exchange gains and losses resulting from the translation of these amounts are included in the consolidated statements of operations.

(g) Use of accounting estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company's management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could differ from the estimates made by management. Capital assets and goodwill and the related amortization, as well as advances to and investment in joint ventures, are the more significant items which reflect estimates.

2. Capital assets:

				1998
	Amortization Rate	Cost	Accumulated Amortization	Net Book Value
Production equipment	20%	$ 2,853,758	$ 1,751,793	$ 1,101,965
Leasehold improvements		520,034	243,847	276,187
Office furnishings and equipment	20%	962,591	419,634	542,957
Automotive equipment	30%	32,673	12,214	20,459
Computer software	50%	614,614	215,808	398,806
		$ 4,983,670	$ 2,643,296	$ 2,340,374

Included in the cost of production equipment and office furnishings and equipment are assets with a cost of $102,295 (1997 – $33,540), accumulated amortization of $28,879 (1997 – nil) and a net book value of $73,416 (1997 – $33,540) representing the Company's 57.76% proportionate share of equipment under capital lease for one of its joint venture enterprises.

				1997
	Amortization Rate	Cost	Accumulated Amortization	Net Book Value
Production equipment	20%	$ 2,697,394	$ 1,511,747	$ 1,185,647
Leasehold improvements		502,908	190,687	312,221
Office furnishings and equipment	20%	760,078	312,703	447,375
Automotive equipment	30%	51,292	14,952	36,340
Computer software	50%	325,626	111,708	213,918
		$ 4,337,298	$ 2,141,797	$ 2,195,501

Notes to consolidated financial statements, continued

3. Investments in joint ventures:

The Company has an interest in two joint ventures: a 57.76% interest in SourceSys, Inc. and a 50% interest in Com-Do Corp., both of which have been accounted for on a proportionate consolidation basis.

(a) SourceSys, Inc.:

In the prior year, the Company and an unrelated entity entered into an agreement to establish a joint venture, SourceSys, Inc., effective January 1, 1997. In exchange for assets contributed by the Company, which included the rights to the SmartCatalog software developed by the Company, the Company received consideration of 2,000,000 common shares representing a 50% interest in the joint venture. In addition, the Company received a promissory note receivable of $1,000,000 U.S., bearing interest at 3% per annum. The contribution of these assets was reflected in these financial statements at the Company's share of the original carrying value, and no gain was to be recognized until such time as the joint venture commenced repayment of the promissory note.

In November, 1997, SourceSys, Inc. recognized a permanent impairment in value of the SmartCatalog software and the goodwill arising on the establishment of the joint venture, and accordingly a writedown of these assets was recorded in the joint venture's accounts. The net effect of these transactions on the consolidated financial statements was the write-down of the Company's share of the joint venture's unamortized goodwill of $214,884.

In addition, the venturers agreed to exchange their outstanding debt in SourceSys, Inc. for additional shares in the joint venture. As a result of this transaction, the Company's promissory note receivable of $1,000,000 U.S. in addition to the Company's working capital advances of $625,000 U.S. were converted into equity. The net effect of these transactions on the consolidated financial statements was the recognition of $374,000 of goodwill and the inclusion of the Company's share of the application by the joint venture of contributed surplus to deficit of $109,755.

As a result of the debt to equity conversion in SourceSys, Inc., the Company's share in the joint venture increased from 50% to 57.76%. Despite the increase in share ownership, a voting agreement between the two venturers precludes the Company from controlling SourceSys, Inc. and consequently retains joint control. These financial statements reflect 57.76% of the joint venture's assets and liabilities, being the Company's share of ownership at January 31, 1998, and reflect the share of revenues and expenses based on the Company's share of ownership at the time the transactions occurred.

(b) Com-Do, Corp.:

During fiscal 1998, the Company and an unrelated party entered into a joint venture incorporated as Com-Do, Corp. to produce a Taekwon-Do multimedia encyclopedia on CD-ROM. In exchange for the contribution of resources and production services recorded at $190,000 (but valued by management at $390,000), the Company received a 50% interest in the joint venture.

(c) Advances to the joint ventures:

To January 31, 1998 the excess of the Company's funding over its proportionate share of the joint ventures' assets was $159,417 (1997 – $315,921). This includes $123,028 (1997 – $311,880) of working capital advances to SourceSys, Inc. The advances bear interest at the rate of 12% per annum and are due June 30, 1999.

Notes to consolidated financial statements, continued

3. Investments in joint ventures, continued:

The consolidated financial statements include the Company's proportionate share of revenues, expenses, assets, liabilities, and equity of its joint ventures before the elimination of intercompany transactions and balances as follows:

	1998	1997
Assets:		
Current assets	$ 362,726	$ 82,929
Capital assets	211,583	868,595
Goodwill	–	242,456
	$ 574,309	$ 1,193,980
Liabilities and equity (deficit):		
Current liabilities	$ 749,434	$ 272,921
Long-term debt	–	223,932
Note payable to the Company	168,232	694,350
Share capital	6,320	2,777
Cumulative translation account	(40,713)	–
Deficit	(308,964)	–
	$574,309	$1,193,980

	1998	1997
Revenues	$ 849,229	$ –
Expenses:		
Cost of sales	489,464	–
Selling, marketing and administrative	881,810	–
Amortization	314,190	–
Research and development	88,151	–
Write-down of goodwill	734,996	–
	2,508,611	–
Net loss	(1,659,382)	–
Retained earnings, beginning of period	–	–
Application of contributed surplus to deficit	1,350,418	–
Deficit, end of period	$ (308,964)	$ –

	1998	1997
Cash provided by (used in):		
Operations	$ (528,150)	$ –
Financing	842,917	–
Investments	(149,209)	–
Cash applied to establishment of the joint venture	–	311,880
	$ 165,558	$ (311,880)

Notes to consolidated financial statements, continued

4. Long-term debt:

	January 31, 1998		
	Face Value	Imputed Interest	Discounted Value
Interest free loan, all currently due	$ 395,552	$16,718	$ 378,834
Demand loan of joint venture, bearing interest at the lender's prime rate plus 4%, secured by a general security agreement over the Com-Do joint venture described in note 3.	104,250		
	$499,802		

	January 31, 1997		
	Face Value	Imputed Interest	Discounted Value
Interest free loan	$ 700,000	$ 101,920	$ 598,080
Less current portion of interest free loan	304,448	27,185	277,263
	395,552	74,735	320,817
Obligation under special employment agreements	223,932		
	$619,484		

(a) Interest free and demand loans:

The Company has an unsecured interest-free loan from the Government of Canada, Department of Western Economic Diversification, to assist with the development of the Company's proprietary products. The Company cannot sell the rights to the related technology without the lender's consent.

The interest-free loan is a financial instrument and has been presented at a discounted value, along with a deferred imputed interest amount. The discounted value results from the calculation of the present value of the loan repayments at an imputed interest rate of prime rate plus 3%. The imputed interest has been deferred and will be amortized to operations over the term of the loan. This is on the same basis as the imputed interest will be charged to operations. The balance of the loan is repayable in three equal quarterly installments in May, August and November 1998. Interest will be charged on any late payments at the Bank of Canada lending rate plus 3%.

The demand loan represents the Company's proportionate share of its joint venture's loan. The Company has provided a $100,000 guarantee on the loan.

(b) Obligation under special employment agreements:

In 1997, pursuant to special employment agreements entered into by one of the Company's joint ventures, the Company was liable for its proportionate share of the joint venture's obligation to pay compensation to certain employees. During 1998, the joint venture was released from the debt in exchange for shares issued.

Notes to consolidated financial statements, continued

5. Share capital:

	1998	1997
Authorized in unlimited numbers:		
Class A and B voting common shares		
Class C and D non-voting common shares		
Class P-1 preferred shares		
Issued:		
18,300,987 Class A shares (1997–18,309,487 shares)	$14,288,642	$14,292,182

(a) Share issues:

During the year ended January 31, 1997, the Company issued 35,987 Class A shares pursuant to its stock option plan for cash proceeds of $35,987. In addition, pursuant to a special warrant indenture dated May 7, 1996, the Company distributed 4,600,000 Special Warrants at a price of $2.25 per Special Warrant. Each Special Warrant entitled the holder, upon exercise and without payment of further consideration, to acquire one common share of the Company. By January 31, 1997 all of the Special Warrants had been exercised and 4,600,000 common shares were issued and distributed for net cash proceeds of $9,473,798.

During the year ended January 31, 1998, the Company repurchased 8,500 of its common shares for $3,540.

(b) Stock options:

(i) The Company granted to the agents of the Special Warrant financing non-assignable warrants, exercisable without payment of any additional consideration at any time, to acquire up to 230,000 share purchase options. Each option entitles the agents to acquire, on or before May 7, 1998, one Class A share of the Company at an exercise price of $2.25 per option.

(ii) The Company has reserved up to 10% of the issued and outstanding shares for issuance of options under its stock option plan. To January 31, 1998, the Company has granted options for the purchase of 1,319,613 Class A shares at $1.00 per share to its employees, directors and consultants, expiring during the period from February 1998 to October 2001.

6. Commitments and contingencies:

(a) The Company is committed to the following minimum annual rental payments under operating lease agreements for office equipment, vehicles and premises:

1999	$126,296
2000	61,579
	$187,875

(b) In general, liabilities of the Company's joint ventures are secured by pledges of the related assets. At times, the joint venture participants may be required to further support these obligations should the realization from joint venture assets not be sufficient. To January 31, 1998, there are no further commitments and contingencies.

7. Research and development:

Costs related to product research, and product development costs which do not meet the Company's criteria for deferral, have been expensed in the Company's statement of operations. These costs include direct expenses for research, product development, market development and an allocation of overhead expenses.

Notes to consolidated financial statements, continued

7. Research and development, continued:

	1998	1997
Total research and development expenditures	$ 1,130,591	$ 1,505,382
Less National Research Council funding	(7,920)	(191,175)
Less amortization of related capital assets	(66,612)	(57,620)
	$ 1,056,059	$ 1,256,587

8. Income taxes:

The expected effective tax rate for an Alberta public company is approximately 45%. The Company incurred a loss before income taxes in fiscal 1998. No recovery of prior years' taxes is available and no tax benefit of the loss has been recognized in these financial statements.

The Company has non-capital losses for income tax purposes of approximately $7,002,000 (1997 - $4,781,000) which may be carried forward to reduce future years' taxable income. These losses expire primarily in the years 2002 to 2005.

As of January 31, 1998, the Company has approximately $360,000 (1997 - $350,000) of unutilized investment tax credits available for income tax purposes. These credits may be used to reduce future federal taxes payable. These credits expire between the years 2003 and 2008.

In addition, the Company has deductions available for income tax purposes in excess of those claimed for accounting purposes in the amount of approximately $957,000 (1997 - $980,000).

The potential income tax benefits of the losses carried forward, the unrecorded investment tax credits and the additional income tax deductions available have not been recognized in these financial statements.

9. Financial instruments:

(a) Fair values:

The carrying values of cash and short-term investments, accounts receivable and accrued revenue, accounts payable and accrued liabilities, production advances, and the capital lease obligation approximate their fair values due to the relatively short periods to maturity of the instruments. The fair value of long-term debt is disclosed in note 4 to these financial statements.

The fair value of the advances to the joint ventures is not significantly different from its carrying value.

(b) Credit risk:

The Company has no individually significant credit risks at January 31, 1998.

(c) Credit facilities:

Effective January 30, 1998, the Company entered into a new financing arrangement with authorized credit facilities of up to $1,300,000 representing a revolving loan of up to $1,000,000 to finance working capital and a $300,000 reducing loan to purchase computer equipment and software. The credit facilities are secured by a general security agreement covering all assets of the company. The revolving loan bears interest at prime plus 0.75% and the reducing loan will bear interest at prime plus 1.25%. As at January 31, 1998, the company has not yet drawn on this available credit facility.

Notes to consolidated financial statements, continued

10. Segmented information:

The Company has three reportable segments based on the products and services it provides: software products, media production services and data categorization services through its joint venture, SourceSys, Inc. The software products segment produces multimedia software applications, mainly the Nereus Multimedia Publishing software and its related components. The media production services segment provides media production services in video, audio, graphics, print, multimedia programming, CD-ROM creation and Web and Internet authoring, and these services are also used to create customized products. The data categorization segment provides both data rationalization and categorization services, otherwise known as Common Language Generation. In 1997, the segment was represented by assets of the newly incorporated SourceSys, Inc. which had no activities during the Company's fiscal 1997. Revenues and expenses in 1997 related to operations of the SmartCatalog division which was transferred to SourceSys, Inc. at January 1, 1997.

The assets and results of operation of the two segments are as follows:

1998	Software products	Media production services	Data categorization services	Corporate overhead	Total
Canadian source revenue	$ 407,811	$4,656,099	$ –	$ –	$5,063,910
Foreign source revenue	278,450	53,650	849,229	–	1,181,329
Revenues from external customers	686,621	4,709,749	849,229	–	6,245,239
Interest income				100,474	100,474
Intersegment revenues	8,501	213,552			222,053
Amortization of capital assets and goodwill	101,146	232,402	137,836	120,268	591,652
Write-down of goodwill			214,884		214,884
Segment profit (loss)	(2,744,910)	(141,780)	(959,379)	(1,300,181)	(5,146,250)
Segment assets	1,007,577	1,875,398	793,935	1,839,848	5,516,758

1997	Software products	Media production services	Data categorization services	Corporate overhead	Total
Canadian source revenue	$ 230,948	$ 4,647,052	$ 53,956	$ –	$ 4,931,956
Foreign source revenue	788,567	213,711	74,127		1,076,405
Revenues from external customers	1,019,515	4,860,763	128,083		6,008,361
Interest income				246,962	246,962
Intersegment revenues	92,510	793,138			885,648
Amortization of capital assets and goodwill	120,095	242,010	6,395	36,632	405,132
Segment profit (loss)	(1,650,985)	622,798	(541,845)	(1,194,042)	(2,764,074)
Segment assets	959,947	2,051,372	738,582	6,857,465	10,607,366

11. Subsequent event:

The Company signed a Memorandum of Understanding ("MOU") with an unrelated third party which will result in the transfer of the assets, liabilities and operations relating to its software products segment (composed of the Nereus Multimedia Publishing software as described in note 10) to a new company to be controlled by the third party. It is anticipated that a final agreement will be signed shortly after May 29, 1998, subject to shareholder approval. The Company will transfer the related assets and liabilities, and operations of its software products segment to a newly created wholly-owned subsidiary at an effective date of March 1, 1998. Following the transfer to the new company, the third party will purchase treasury shares in the new company such that it will obtain 54.54% of the newly created company.

CORPORATE INFORMATION

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President & Chief Executive Officer
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Edmonton, Alberta

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Director
Vice Chairman, Beau Canada Exploration Ltd.
Calgary, Alberta

William DeJong
Director
Partner, Ballem MacInnes
Calgary, Alberta

Barry Chugg
Director
Vice President
Vicom Multimedia Inc.
Calgary, Alberta

Dale Hardy
Director
Vice President, Vicom Multimedia Inc.
President, Nereus Division
Edmonton, Alberta

Paul Braconnier
Chief Financial Officer
Vice President, Finance
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Registrar and Transfer Agent
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Calgary, Alberta

Stock Exchange Listing
The Alberta Stock Exchange
Trading Symbol: VMI

ANNUAL MEETING

The annual meeting of shareholders of Vicom Multimedia Inc. will be held at 10:00 am on Thursday, May 28, 1998 at the Prince of Wales Armouries Heritage Centre, 10440 - 108 Avenue Edmonton, Alberta.

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